No. 76-1393

In the Supreme Court of the United States

OCTOBER TERM, 1976

JACK D. RINGWALT, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The memorandum opinion of the district court (Pet. App. 11-16) is not officially reported. The opinion of the court of appeals (Pet. App. 1-9) is reported at 549 F.2d 89.

JURISDICTION

The judgment of the court of appeals (Pet. App. 10-11) was entered on February 16, 1977. The petition for a writ of certiorari was filed on April 11, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the transfer of all of the operating assets from one corporation to another identically-constituted corporation with the same shareholders, which thereupon carried on the business of the transferor, was a reorganization within the meaning of Section 368(a)(1)(D) of the Internal Revenue Code of 1954, so that the transferor's distribution of its retained cash to its shareholders was taxable as a dividend under Section 356 of the Code.

2. Whether petitioner Ringwalt, who received the corporate distribution in his capacity of trustee of a short-term trust in 1967, was individually taxable on the distribution in that year under Sections 671 and 677(a)(2) of the Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 368, 671, and 677 of the Internal Revenue Code of 1954 (26 U.S.C.) and of Sections 1.671-2 and 1.677(a)-1 of the Treasury Regulations on Income Tax (26 C.F.R.) are set forth in the Appendix, *infra*, pp. 1a-5a.

STATEMENT

Ringwalt & Liesche, Inc. (R & L, Inc.) was incorporated in Nebraska on July 1, 1949, and operated a general insurance agency. Petitioner Jack D. Ringwalt [1] owned 84 percent of the stock of R & L, Inc.

[1] References to Ringwalt are to petitioner Jack D. Ringwalt. Jean W. Ringwalt is a party solely because she filed a joint return with her husband for the year in issue.

Ringwalt originally owned this stock outright. After April 30, 1959, however, he held his interest in R & L, Inc. as a self-declared trustee under a short-term trust. The balance of the R & L, Inc. stock was owned as follows: petitioner Philip L. Liesche—eight percent, Charles B. Wortz—six percent, and Daniel J. Gross—two percent (Pet. App. 2; R. 24).[2]

From its organization until its liquidation in 1967, R & L, Inc.'s board of directors consisted of Ringwalt, Liesche, and Wortz. Throughout this period, Ringwalt served as president, Liesche as vice-president, and since 1952, Wortz served as treasurer. By March 31, 1967, R & L, Inc. had accumulated earnings and profits of $810,421.50 (Pet. App. 2; R. 23-25).

At the beginning of January, 1967, R & L, Inc. owned 2,582 shares (51 percent) of National Fire and Marine Insurance Company, a Nebraska casualty insurance company formed by Ringwalt. By a tender offer dated February 23, 1967, Berkshire-Hathaway, Inc. offered to purchase all of the outstanding shares of National Fire and Marine. Ringwalt had previously committed himself in writing to accept this offer with respect to all National Fire and Marine stock that he owned or controlled. Accordingly, on or about March 16, 1967, R & L, Inc. sold its National Fire and Marine stock to Berkshire-Hathaway, Inc. for $839,100, and realized a gain of $706,301.87 (Pet. App. 3, 12; R. 26-27).

[2] "R." refers to the record appendix filed in the court of appeals.

In anticipation of this sale, the shareholders of R & L, Inc., on February 22, 1967, adopted a resolution authorizing and directing the dissolution of the corporation as of March 31, 1967. At that time, the shareholders contemplated that the operating assets of R & L, Inc. (consisting of insurance renewals and associated assets) would be sold to a new company to be formed by Ringwalt and which was to commence business on April 1, 1967. R & L, Inc. had its operating assets valued by an outside appraiser, who concluded that the new company could use a value of $165,000 as a basis for amortization for federal tax purposes (R. 27, 28, 50).

On April 1, 1967, the new company was organized as a Nebraska corporation under the name Ringwalt & Liesche Co. (R & L Co.). The shares of the new corporation were held in the same proportions as in the old corporation: Ringwalt—84 percent, Liesche—eight percent, Wortz—six percent, and Gross—two percent. Ringwalt, Liesche, and Wortz likewise comprised the board of directors of R & L Co., and respectively served as president, vice president, and treasurer. On April 1, 1967, R & L Co. paid or credited to R & L, Inc. $165,000 for its operating assets plus $5,000 for the use of a similar corporate name. R & L Co. continued to conduct the business formerly conducted by R & L, Inc. in substantially the same manner and at the same location (Pet. App. 3; R. 27-30).

On or about April 1, 1967, R & L, Inc. was dissolved, and distributed to its shareholders its remaining nonoperating assets, totalling $1,110,421.50. Of

this amount, $932,754.06 was distributed to petitioner Ringwalt in his capacity as trustee under a short-term trust, $88,833.72 to petitioner Liesche, and the balance to the remaining two shareholders, including pro rata amounts derived from R & L, Inc.'s sale of the National Fire and Marine stock and the transfer of its operating assets to R & L Co. (Pet. App. 3; R. 27, 30).

The principal purpose for the dissolution of R & L, Inc. and the formation of R & L Co. was to avoid federal income taxes (Pet. App. 15) by means of (1) the non-recognition by R & L, Inc. of its gain on the National Fire and Marine stock, pursuant to the special liquidation provisions of Section 337 of the Code, (2) the withdrawal by its shareholders of the earnings and profits of R & L, Inc. at capital gain rates, and (3) the establishment of a stepped-up basis in the operating assets with respect to which R & L Co. might claim deductions for amortization or depreciation (R. 29).

Prior to the liquidation of R & L, Inc., petitioner Ringwalt had established on April 30, 1959, a trust known as the Ringwalt Short Term Trust (trust). This trust was to continue for ten years and one day, and terminated on May 1, 1969. Ringwalt was the sole trustee, and his children were the income beneficiaries. Ringwalt retained a reversionary interest in the corpus. Ringwalt transferred to himself, as trustee, the shares of R & L, Inc. stock which he owned. The trust held this stock until R & L, Inc. was dissolved on April 1, 1967. At that time, Ringwalt

received the $932,754.06 liquidating distribution from R & L, Inc., in his capacity as trustee, although he reported the gain from this distribution on his 1967 individual income tax return. Thereafter, the trust invested this money in securities of publicly held companies, and, when the trust terminated on May 1, 1969, the funds were paid over to Ringwalt (Pet. App. 2-3, 11-13, 15).

Under the trust, Ringwalt had sole discretion to allocate trust receipts between principal (*i.e.*, to himself as holder of the reversionary interest) and income. Although Ringwalt's power of allocation had to be exercised in a fiduciary capacity, any such decision made in good faith was conclusive on all beneficiaries or any other interested persons. Ringwalt allocated the liquidating distribution from R & L, Inc. to principal, and the resulting accumulation was eventually distributed to him individually upon termination of the trust (Pet. App. 3, 15; R. 30, 40-42).

On its federal income tax return for its taxable year ended March 31, 1967, R & L, Inc. reported no gain with respect to its sale of the National Fire and Marine stock, or with respect to the transfer of its operating assets to R & L Co. On their individual returns for 1967, petitioners Ringwalt and Liesche each reported the liquidating distribution received from R & L Inc. as long-term capital gain, in exchange for his stock in the corporation. On audit, the Commissioner of Internal Revenue determined that the series of steps whereby R & L Inc. transferred its assets to R & L Co. and then dissolved was

a "reorganization" within the meaning of Section 368(a)(1)(D) of the Internal Revenue Code of 1954. Thus, R & L, Inc. was not entitled to the nonrecognition of income benefits of Section 337, and its shareholders were required to treat the liquidating distribution, to the extent of their respective gain, as having the effect of the distribution of a dividend under Section 356, rather than as capital gain (Pet. App. 4, 13; R. 32).

Accordingly, the Commissioner determined a deficiency of $176,575.76 against R & L, Inc., which was assessed against Ringwalt as the transferee of corporate assets under Section 6901. The Commissioner also determined deficiencies against Ringwalt and Liesche individually of $150,347.97 and $11,401.18, respectively, treating the R & L, Inc. liquidating distributions as dividends, with appropriate adjustments made for (i) their capital contributions to R & L Co., as well as (ii) their pro rata shares of the deficiencies determined against R & L, Inc., which had reduced R & L Inc.'s earnings and profits (Pet. App. 4, 13; R. 32-33).

In this refund suit brought by petitioners in the United States District Court for the District of Nebraska, the district court held that the transaction between R & L, Inc. and R & L Co. was a reorganization under Section 368(a)(1)(D), so that the resulting distributions were taxable to petitioners as dividends (Pet. App. 10-15). The court of appeals affirmed (Pet. App. 1-11).

As the court of appeals observed, the continuity of proprietary interest required for a reorganization

was satisfied because Ringwalt retained a substantial beneficial interest in the R & L, Inc. stock held in trust. Moreover, under Section 677(a)(2), as a grantor-owner of the trust, Ringwalt was the owner of the R & L, Inc. stock held in trust because the 1967 R & L, Inc. liquidating distribution was allocated by Ringwalt to trust corpus, held for future distribution to himself, and was in fact distributed to himself outright when the trust terminated in 1969. As a result, the court of appeals held that Ringwalt was properly taxable on the R & L, Inc. distribution in 1967, when it was received by the trust, and not in 1969, upon the termination of the trust (Pet. App. 9, n. 11).

ARGUMENT

1. The court of appeals correctly held that the transaction between R & L, Inc. and R & L Co. was a reorganization within the meaning of Section 368(a)(1)(D) of the Code. As the court of appeals pointed out (Pet. App. 5-6), the transaction in this case is a classic "liquidation-reincorporation," which has been uniformly held to be a Section 368(a)(1)(D) reorganization. See, *e.g.*, *Babcock* v. *Phillips*, 372 F. 2d 240 (C.A. 10), certiorari denied, 387 U.S. 918; *Davant* v. *Commissioner*, 366 F. 2d 874 (C.A. 5), certiorari denied, 386 U.S. 1022; *Moffatt* v. *Commissioner*, 363 F. 2d 262 (C.A. 9), certiorari denied, 386 U.S. 1016; *Commissioner* v. *Morgan*, 288 F. 2d 676 (C.A. 3), certiorari denied, 368 U.S. 836; *Liddon* v. *Commissioner*, 230 F. 2d 304 (C.A. 6), certiorari denied, 352 U.S. 824; *Bard-Parker Co.* v. *Commissioner*, 218 F. 2d 52 (C.A. 2), certiorari denied, 349 U.S. 906; *Lewis* v. *Commissioner*, 176 F. 2d 646 (C.A. 1); *Survaunt* v. *Commissioner*, 162 F. 2d 753 (C.A. 8).

However, petitioners argue that the transaction was not a reorganization because Ringwalt, while holding his stock in R & L, Inc. as a self-declared trustee under a short-term trust, was not a "shareholder" of that corporation within the meaning of Section 368(a)(1)(D). Pursuant to that provision, a "reorganization" includes a transaction in which the assets of one corporation are transferred to another corporation, and either the transferor corporation or one or more of its "shareholders," or both, are in control of the transferee corporation immediately after the transfer.

But the court of appeals correctly applied the settled principle that beneficial enjoyment, as opposed to bare legal title, is the determining factor in assessing the continuity of proprietary interest necessary for a reorganization (see Pet. App. 7-8). See, *e.g.*, *Commissioner* v. *National Bellas Hess, Inc.*, 220 F. 2d 415 (C.A. 8), rehearing denied, 225 F. 2d 340; *Bondy* v. *Commissioner*, 269 F. 2d 463 (C.A. 4); *Ridgewood Cemetery Co.* v. *Commissioner*, 26 B.T.A. 626; *Federal Grain Corp.* v. *Commissioner*, 18 B.T.A. 242. Moreover, as the court of appeals correctly pointed out (Pet. App. 8-9), a grantor, such as Ring-

walt, who is a substantial owner of a trust under the grantor trust provisions (Sec. 671, *et seq.*, Internal Revenue Code of 1954 (26 U.S.C.)) should, in appropriate circumstances, be treated as actually owning the trust assets. See *Swanson* v. *Commissioner*, 518 F. 2d 59 (C.A. 8); cf. *Helvering* v. *Clifford*, 309 U.S. 331.

The record amply supports the application of these principles by both courts below. Thus, the court of appeals found "that Ringwalt was treated appropriately as the owner of 84% of the R & L, Inc. stock because of the significant incidence of his ownership over the trust property," and that "The only beneficial right that Ringwalt relinquished under the trust agreement was the right to receive trust receipts allocable to income" for the ten year duration of the trust (Pet. App. 7-8). On these facts, the court properly held (Pet. App. 8-9) that Ringwalt was a grantor-owner of the trust under Section 677(a)(2), Appendix, *infra*, pp. 2a-3a, because "In accordance with Ringwalt's powers as trustee, the 1967 liquidating distribution received from dissolution of R & L, Inc. was allocated to principal, held by the trust for future distribution and actually distributed to Ringwalt upon termination of the trust in 1969" (Pet. App. 8). These facts exactly fit the operative words of Section 677(a), which provides that "The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is * * * (2) held or

accumulated for future distribution to the grantor * * *."[3]

2. Finally, petitioners contend (Pet. 20-21) that Ringwalt should be taxable upon the R & L, Inc. distribution upon the termination of the trust in 1969, and not in 1967, when the trust received the distribution. But under Section 677(a)(2), Ringwalt was the owner of the trust in 1967 because the R & L, Inc. distribution was allocated to principal, held for future distribution to Ringwalt, and was in fact distributed to him free of the trust in 1969. Thus, under Section 671, Ringwalt was required to and did report that income on his individual return for 1967 as if he had personally received it in that year. Treasury Regulations, Section 1.671-2(c), Appendix, *infra*, p. 4a. See *Graff* v. *Commissioner*, 117 F.2d

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[3] Contrary to petitioners' argument (Pet. 12, 19), the decision below does not conflict with *Commissioner* v. *Berghash*, 361 F.2d 257 (C.A. 2), affirming *per curiam*, 43 T.C. 743. There, the court held that the liquidation-reincorporation of a corporation was not a (D) reorganization because the former 10 percent shareholder of the "old" corporation owned only 50 percent of the stock of the "new" corporation. Thus, the 80 percent control requirement (see Section 368(c), Appendix, *infra*, p. 1a) for a (D) reorganization was not met. Here, however, petitioner Ringwalt owned 84 percent of the stock of the newly-formed R & L Co. and was therefore in "control" of that corporation.

Nor does the decision in this case conflict with *Commissioner* v. *Gordon*, 382 F.2d 499 (C.A. 2) (Pet. 19). Apart from the fact that the court of appeals' decision in *Gordon* was reversed by this Court in *Commissioner* v. *Gordon*, 391 U.S. 83, that case involved the spin-off provisions of Section 355 and not Section 368(a)(1)(D).

247 (C.A. 7); Rev. Rul. 58-242, 1958-1 Cum. Bull. 251.

Petitioners argue (Pet. 21) that these rules are applicable only if the R & L, Inc. liquidating distribution is determined to be capital gain. But Section 677(a) is not so limited, and refers to all items of trust "income" that are, or may be, held for future distribution to the grantor. Trust "income" for this purpose is determined without regard to characterization of the item as "income" or "principal" for purposes of trust accounting under state law. Treasury Regulations, Section 1.671-2(b), Appendix, *infra*, pp. 3a-4a. Indeed, petitioners concede (Pet. 21) that Ringwalt properly reported the liquidating distribution as his own income in 1967, because he did in fact accumulate it for future distribution to himself. That is all that Section 677(a)(2) requires.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) *Reorganization.*—

(1) *In general.*—For purposes of parts I and II and this part, the term "reorganization" means—

* * * * *

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

* * * * *

(c) *Control.*—For purposes of part I (other than section 304), part II, and this part, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

SEC. 671. TRUST INCOME, DEDUCTIONS, AND CREDITS ATTRIBUTABLE TO GRANTORS AND OTHERS AS SUBSTANTIAL OWNERS.

Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.

SEC. 677. INCOME FOR BENEFIT OF GRANTOR.

(a) *General Rule.*—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be—

(1) distributed to the grantor * * *;

(2) held or accumulated for future distribution to the grantor * * *; or

(3) applied to the payment of premiums on policies of insurance on the life of the grantor * * * (except policies of insurance irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions)).

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

* * * * *

Treasury Regulations on Income Tax, 1954 Code (26 C.F.R.):

§ 1.671-2 *Applicable principles.*

* * * * *

(b) Since the principle underlying subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Code, is in general that income of a trust over which the grantor or another person has retained substantial dominion or control should be taxed to the grantor or other person rather than to the trust which receives the income or to the beneficiary to whom the income may be distributed, it is ordinarily immaterial whether the income involved constitutes income or corpus for trust accounting purposes.

Accordingly, when it is stated in the regulations under subpart E that "income" is attributed to the grantor or another person, the reference, unless specifically limited, is to income determined for tax purposes and not to income for trust accounting purposes. When it is intended to emphasize that income for trust accounting purposes (determined in accordance with the provisions set forth in § 1.643(b)-1) is meant, the phrase "ordinary income" is used.

(c) An item of income, deduction, or credit included in computing the taxable income and credits of a grantor or another person under section 671 is treated as if it had been received or paid directly by the grantor or other person (whether or not an individual). * * *

(d) Items of income, deduction, and credit not attributed to or included in any portion of a trust of which the grantor or another person is treated as the owner under subpart E are subject to the provisions of subparts A through D (section 641 and following), of such part I.

* * * * *

§ 1.677(a)-1 *Income for benefit of grantor, general rule.*

(f) *Accumulation of income.* If income is accumulated in any taxable year for future distribution to the grantor (or his spouse in the case of property transferred in trust by the grantor after Oct. 9, 1969), section 677(a)(2) treats the grantor as an owner for that taxable year. The exception set forth in the last sentence of section 677(a) does not apply merely because the grantor (or his spouse in the case of prop-

erty transferred in trust by the grantor after Oct. 9, 1969) must await the expiration of a period of time before he or she can receive or exercise discretion over previously accumulated income of the trust, even though the period is such that the grantor would not be treated as an owner under section 673 if a reversionary interest were involved. Thus, if income (including capital gains) of a trust is to be accumulated for 10 years and then will be, or at the discretion of the grantor, or his spouse in the case of property transferred in trust after October 9, 1969, or a nonadverse party, may be, distributed to the grantor (or his spouse in the case of property transferred in trust after Oct. 9, 1969), the grantor is treated as the owner of the trust from its inception. If income attributable to transfers after October 9, 1969 is accumulated in any taxable year during the grantor's lifetime for future distribution to his spouse, section 677(a)(2) treats the grantor as an owner for that taxable year even though his spouse may not receive or exercise discretion over such income prior to the grantor's death.

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